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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
2000 Biennial Regulatory Review --	)	CC Docket No. 00-199
Comprehensive Review of the Accounting	)	
Requirements and ARMIS Reporting	)	
Requirements for Incumbent Local Exchange	)	
Carriers: Phase 2 and Phase 3	)	

REPLY COMMENTS
OF THE
UNITED STATES TELECOM ASSOCIATION

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SUMMARY

Any proposals to increase regulation, including adding new accounts and subaccounts in Part 32 or new columns in ARMIS, are clearly out of place in a biennial review proceeding. The Commission should take its responsibilities for biennial review seriously and implement long overdue streamlining of its accounting and reporting requirements.

Concerns expressed by state regulators that data will no longer be available if USTA's streamlining proposals are adopted are unfounded. The current Federally prescribed accounts and reports are no longer necessary. Regulation has changed at both the Federal and state levels from embedded accounting cost-based regulation to some form of price regulation. The existing accounting and reporting regulations were designed to provide regulatory oversight for the former and now must be streamlined to reflect the latter. Many telecommunications providers, including CLECs, wireless, cable and IXCs, offer services without keeping Part 32 books or reporting ARMIS data. Incumbent LECs will maintain data necessary to serve their business purposes and that data can be provided to state regulators.

Contrary to some commenters, Class A accounts are not required for universal service. The Commission adopted nationwide averages based on data gathered from many different sources rather than company specific cost-based input values to develop its proxy model for non-rural carriers. Even the Class B ARMIS data used had to be massaged to be of use. Class B and GAAP will provide regulators with the ability to track investment and expense data as well as Common Support Services.

UNE prices must be forward looking and historical accounting data are not utilized to set UNE rates. Class A accounts are not required for UNE pricing.

Class A accounts are not required for the allocation of costs in Part 64. USTA provides a chart showing no significant difference in expense to investment ratios using either Total Company data or Total Regulated data.

USTA urges the Commission to permit all incumbent LECs to utilize Class B accounts and to implement USTA's streamlining proposals, including its proposals to consolidate and eliminate certain ARMIS reports.

Finally, all mid-sized carriers should be permitted to utilize Class B accounts and should be relieved of all requirements to file a CAM, conduct CAM audits and file ARMIS reports.

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In the Matter of 2000 Biennial Regulatory Review -- Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2 and Phase 3	)))))))	CC Docket No. 00-199

REPLY COMMENTS
OF THE
UNITED STATES TELECOM ASSOCIATION

The United States Telecom Association (USTA) respectfully submits its reply to the comments filed December 21, 2000 in the above-referenced proceeding.

I. THE CURRENT ACCOUNTING AND REPORTING REQUIREMENTS DO NOT REFLECT THE FUNDAMENTAL CHANGES THAT HAVE OCCURRED IN THE TELECOMMUNICATIONS INDUSTRY

In its comments, USTA noted that the current Part 32 accounts and the current ARMIS reporting requirements are an anachronism in today's competitive telecommunications environment. Part 32 no longer reflects how incumbent LECs do business and the Part 32 books are kept only because the Commission requires that they be kept. The ARMIS reports do not reflect today's competitive telecommunications environment. The Commission's accounting and reporting requirements have not changed as other changes have occurred. Such changes reflect the evolving telecommunications environment and include the implementation of price cap regulation, the passage of the Telecommunications Act of 1996, the adoption of pricing flexibility, and the grant of Section 271 relief. The accounting and reporting requirements have not changed despite the fact that the Commission is required to review these requirements every two years and eliminate those that no longer serve the public interest. These requirements have not changed despite the fact that the Commission has the authority to forbear from regulation if competition will be enhanced as a result. As the Wisconsin PSC points out, the fundamental nature of the industry has changed and the Uniform System of Accounts has not evolved accordingly. Wisconsin PSC at 3,4. Significant streamlining to provide incumbent LECs with meaningful administrative relief and greater flexibility is needed now in Phase 2. The Commission should begin the transition to GAAP accounting and financial reporting that are appropriate in a competitive environment.

USTA has been providing the Commission with recommendations to streamline these requirements for years. Until now, the Commission has not even addressed these recommendations. Instead, the Commission has made incremental changes that have not resulted in significant administrative relief, except in some cases for small and some mid-sized carriers. Such limited changes fall short of the deregulatory approach mandated in the Telecommunications Act of 1996. For example, what began as a two-phase biennial review proceeding has now evolved into three phases and there is still no definitive plan to eliminate these requirements. In Phase I, the Commission failed to eliminate a single account or subaccount in Part 32. In Phase 2, even though the Commission finally requested comment on USTA's streamlining proposals, the Commission also requested comment on proposals to increase the number of accounts and subaccounts and to increase the reporting detail.

Increasing regulation is clearly not the object of a Section 11 biennial review proceeding. Section 11 requires the Commission to examine regulations "in effect at the time of the review" and to determine if such rules are no longer necessary in the public interest as the result of meaningful economic competition between providers of telecommunications services. Replacing one set of regulations with another is clearly not the intent of the Biennial Review. Even the

Commission recognizes that "as a part of the biennial review process, we do not intend to impose new obligations on parties in lieu of current ones, unless we are persuaded that the former are less burdensome than the latter and are necessary to protect the public interest".[1] There is no evidence provided in the comments that any of the new regulations proposed by the state regulators are less burdensome than the current requirements. In fact, as USTA and many parties point out, they are more burdensome.

The very nature of regulation itself has changed to reflect a competitive environment as was required by the 1996 Act. Price cap regulation has been in effect for over a decade at the Federal level and sharing has been eliminated. The last vestiges of rate of return regulation have been removed from price cap regulation and the direct link between prices and costs has been eliminated. Price cap companies must forgo the lower formula adjustment mechanism to obtain pricing flexibility. Price cap companies have reached agreement with IXCs to dramatically reduce access charges. The incumbent LECs under rate of return regulation are seeking Commission approval of an incentive regulation plan that freezes revenues per line thereby forcing carriers to reduce costs and that also reduces access charges. In addition, the Commission has adopted a universal service mechanism for non-rural carriers that is not based on embedded costs, but utilizes a forward-looking proxy model. The Commission is considering a freeze of the separations factors. Practically every state has adopted some form of alternative regulation for incumbent LECs, while CLECs generally operate without state review of rates.[2] Regulatory oversight functions have transitioned from rate of return/embedded accounting cost regulation to incentive-based regulation at both the Federal and state level. The existing accounting and reporting requirements were designed to accommodate regulatory oversight

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[1] The 2000 Biennial Regulatory Review, CC Docket No. 00-175, *Report*, FCC 00-456 (rel. Jan. 17, 2001).
[2] *See, State Telephone Regulation Report,* Sept. 29, 2000, Oct. 13, 2000 and Oct. 27,2000.

responsibility for rates based on embedded accounting costs. UNE rates, interconnection charges, and universal service support for non-rural carriers are primarily based on forward-looking costs, not embedded accounting costs. The detailed accounting and reporting of such costs used solely for regulatory purposes can be streamlined and eventually eliminated.

Further, it is time to recognize and address the fact that the Part 32 and ARMIS requirements only apply to certain incumbent LECs. No other providers of telecommunications services, including CLECs, IXCs, cable operators, and wireless providers, are required to keep Part 32 books of account or are required to file ARMIS reports. The differences in the accounting and reporting requirements between incumbent LECs, CLECs, IXCs, wireless and cable providers cannot be justified by market conditions, regulatory needs or existing laws. Even the Commission, recognizing the unfair burden imposed by these requirements, has lessened the requirements for small and mid-sized incumbent LECs. These carriers are permitted to utilize Class B Part 32 accounts and are not required to file ARMIS reports. It is long past time for the Commission to take a serious look at the Part 32 and ARMIS requirements and to take seriously its obligations under Section 11 as well as the opportunity under Section 10 to streamline these rules with the ultimate goal being to eliminate them as they exist today. It is highly unlikely that if the Commission were to start with a clean slate today, it would adopt anything that remotely resembles the current accounting and reporting rules. It is very likely that the Commission would be utilizing GAAP accounting and reporting that more closely resembles SEC reports.

It is not surprising that the competitors of the incumbent LECs oppose reducing any of the regulatory requirements imposed on incumbent LECs. They recognize that these regulations impede incumbent LECs' abilities to compete in the marketplace. They recognize that these regulations impose costs on the incumbent LECs that they do not have to bear. They recognize that they can use reported data to gain an advantage over the incumbent. It would not be in their self-interest to suggest that these requirements be reduced. They repeat unsupported claims that competition is not sufficient or even incredibly that competition does not exist. These statements are obviously not correct. If competition did not exist, incumbent LECs could not obtain relief from Section 271 restrictions or would not be allowed pricing flexibility for special and switched access services under the Commission's rules.

While some state regulatory commissions opposed USTA's streamlining proposals, the basis for the opposition is not compelling and in certain cases, as will be explained below, stems from a misunderstanding of the current rules or of USTA's proposals. State commissions have independent authority to regulate within their state borders. State regulators must accept the fact that the 1996 Act changed the Federal regulatory model, established in 1934, to a competition model. The 1996 Act requires that the Commission reduce regulation and rely instead on the marketplace. Federal regulations such as the current Part 32 accounts and the ARMIS reports must be streamlined and eventually eliminated and must not be maintained simply to facilitate state regulation, particularly if the state commission lacks authority to promulgate such requirements.

The comments of some of the state regulators speak of the need for uniformity, but uniformity does not exist today in the states. There are many telecommunications providers operating in every state that do not keep Part 32 books and that do not file ARMIS reports. These providers, including state-owned telecommunications networks, are being certified by state regulators to provide common carrier service within the state and to receive universal service support without any reliance on Part 32 books of account or any ARMIS data. Some states allow CLECs to be designated as carriers of last resort even though their rates are not regulated, they do not keep Part 32 books of account and do not file ARMIS reports.

Some state regulators also claim that they need these Federal regulations so they can compare rates and activities of the incumbent LECs in other states. However, states have different requirements for provisioning service (Idaho, for example, has its own system of accounts), different rate regulation plans, different population densities, different levels and types of competition and different geographies. Cable design differs depending on customer location and density. Density also impacts investment and utilization calculations. The companies that provide service in more than one state will have different business plans, network architectures and corporate structures to reflect these differences. Even with a single architecture there are multiple designs. Comparisons to other states are not always useful and become even less meaningful in a competitive environment. It is more likely that the decisions of state regulators are based on particular facts and data specifically requested by the state commission and supplied by the incumbent LEC. What happens in other states may not be germane to the facts presented. Greater flexibility is needed to reflect unique external and internal company operations.

Finally, some state regulators claim that they lack the resources to obtain and/or analyze data. State commissions can seek authority and funding from their state legislatures needed to regulate the companies that operate within their borders consistent with other state statutes. Much of the ARMIS data is available through other public sources that the states could utilize to obtain information. It is not clear why any of the reasons provided by some of the state commissions are sufficient to maintain the current Federal accounting and reporting requirements, much less to increase Federal regulation as some states recommend. Specific issues raised by the states and other parties will be addressed below.

II. CLASS B ACCOUNTS CAN BE UTILIZED BY ALL INCUMBENT LECS

In Phase 2, the Commission should immediately adopt Class B accounts for all incumbent LECs. As USTA explained in its comments, the existing Part 32 Class A accounts are not used in competitive data reporting. Part 32 does not allocate costs among operations, jurisdictions or services and includes nonregulated costs. The separations rules utilize Class B accounts. Part 32 does not identify tariff costs. Class A accounts are not required to establish prices under price cap regulation or to arbitrate interconnection agreements.

NARUC and some state regulatory commissions argue that Class A accounts are necessary for universal service and UNE pricing. Much of the regulatory oversight now occurring at both the Federal and state level is focused on universal service and quality of service rather than on rate structures based on embedded accounting costs. As explained above, traditional rate structures have been changed or are in the process of being changed at both the Federal and state levels thereby eliminating the need for Class A accounts.

Class A accounts are not necessary for universal service. In the universal service order for non rural LECs, the Commission concluded that high cost support should be based on forward-looking costs.[3] The Commission was quite adamant that forward-looking costs, not embedded accounting costs, are the appropriate basis for economic decisions in a competitive marketplace in order to send correct signals for entry and investment.

> "We reject the explicit or implicit assumption of most LEC commenters that the cost of maintaining incumbent LEC embedded plant is the best predictor of the forward-looking investment predicted by the model. We find that averages, rather than company specific data, are better predictors of the forward-looking costs that should be supported by the federal high cost model. Scrutinizing company-specific data to identify such anomalies and to make the appropriate adjustments to the company-proposed input values would be exceedingly time consuming and complicated given the number of inputs to the model...The model reflects differences in structure costs by using different values, for the type of plant,

[3] Federal State Joint Board on Universal Service, *Tenth Report and Order*, 14 FCC Rcd 20156 (1997).

> the density zone and soil conditions... Because high-cost support is portable, a competitive eligible telecommunications carrier, rather than an incumbent LEC, may be the recipient of the support. We find that using nationwide averages is a better predictor of the forward-looking costs that should be supported by the federal high-cost mechanism than any particular company costs."[4]

Thus, the Commission adopted nationwide averages rather than company specific cost-based input values for the support mechanism. The Commission used various studies and data sources to determine the input values necessary to develop the base period expense to investment ratios and overhead factors for its forward looking cost proxy model. For example, NRRI supplied cable and wire inputs and HAI and BCPM provided cable and wire fill factors. Bureau of Economic Analysis data and individual LEC depreciation studies were used to determine switching investment inputs. The Commission relied on data contained on the SEC Form 10-K to make adjustments for one-time events. Carriers supplied specific data requests. ARMIS Class B data were used to estimate overhead costs, but the Commission had to adjust the ARMIS non-plant specific overhead expense data and use regression analysis to obtain a result.[5]

The difficulty with massaging the ARMIS data to develop initial study input values calls into question the continuing value of ARMIS data for future studies. Since the base period expense to investment ratios and overhead factors have been developed, ARMIS data is not required in the future. The Commission can simply adjust the existing study factors for inflation. The Commission already has converted Common Support Services expense from 1996 data to 1999 values using adjustment factors.[6] The Commission could also use data currently reported to NECA for the "hold harmless" studies to provide expense data. Using the NECA data, which is already consolidated at an industry level, would eliminate duplicative reporting as well, until the Commission completes the transition to GAAP. Class B and GAAP provide regulators with

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[4] *Id.* at paras. 348, 356, 357 and 360.
[5] *Id* at footnote 1161.

the ability to track investment and expense data as well as Common Support Services. Class A accounts are not required for purposes of determining federal universal service support.

Some states stated that ARMIS Class A data is used for state universal service support studies. Traditionally, state regulators have used individual data requests to gather data necessary to review cost studies and rates rather than the prescribed Federal accounts and mandated Federal reports. As USTA explained in its comments, Class A account data is not needed to determine support for the rural universal service mechanism as proposed by the Rural Task Force.

Like the non-rural universal service support mechanism, UNE prices are also forward-looking. Historical accounting data are not the basis for UNE rates. UNE prices are established through negotiation. If state arbitration is required, the states must follow Federal guidelines based on forward-looking costs, not embedded accounting costs. UNE overheads are calculated similar to universal service overheads. Class A accounts are not required to evaluate UNE data.

RUS claims that Class A accounts are required for RUS telephone borrowers. However, the RUS regulations actually only require that each RUS borrower maintain accounts and records in accordance with the rules of the regulatory body with jurisdiction over the borrower. 7 CFR 1770.11(a). Only a borrower not subject to regulatory control with annual regulated telecommunications revenues over $100,000,000 must maintain Class A accounts. 7 CFR 1770.11(b)(1). A borrower not subject to regulatory control with annual regulated telecommunications revenues of less than $100,000,000 must maintain Class B accounts. 7 CFR 1770.11(b)(2).

Some commenters also contended that Class A accounts are required for the allocation of costs in Part 64 of the Commission's rules. The class A level of detail is not required.

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[6] *Id.* at para. 381.

Furthermore, the use of Class B accounts for Part 64 will not materially impact the ratios used to determine universal service support. As explained above, the Commission has alternative sources of data to develop overhead factors and expense to investment ratios. As the attached chart demonstrates, there is no significant difference in the resulting expense to investment ratios using either Total Company (before Part 64 allocation) data or Total Regulated (after Part 64 allocation) data.[7]

Even with the elimination of Class A accounts incumbent LECs will still maintain data at the level required for business purposes. This data can be made available to regulators in order to set depreciation rates and to categorize plant as well as for ratemaking and monitoring purposes as needed.

III. NO NEW ACCOUNTS SHOULD BE ADOPTED IN THIS PROCEEDING

As USTA and many commenters explained, the new accounts and subaccounts listed in the NPRM should not be adopted. First, adding new regulations is contrary to the purpose of the Section 11 biennial review and the Commission has no authority under Section 11 to add new rules. Second, not all states require the same information because not all states have the same regulations. Adding regulations at the Federal level places a burden on incumbent LECs to keep accounts or to provide information that the LECs do not need to operate their businesses and that some state regulators do not need. Third, the proposals supported by some of the state commissions are unnecessarily burdensome. If adopted, the USOA would become an ongoing series of special studies. The new accounts and subaccounts would require special studies to identify the detail. For example, the loop and interoffice transport breakdown cannot be accomplished without a special study. According to Cincinnati Bell, this would require a manual inspection that would be extremely costly and time consuming to perform. Cincinnati Bell at 5.

[7] *See* attachment.

Sprint observes that the wholesale and retail subaccounts pose the same problems as the loop and interoffice transport breakdown. Sprint at 10. Sprint states that the switched access revenue subaccounts and the new accounts for reciprocal compensation, Federal universal service, state universal service, resale, wholesale and collocation should all be rejected. Sprint at 10. Even the new accounts proposed by the Wisconsin PSC would require special studies, as the Wisconsin proposal would mischaracterize some retail costs. Turning the current system into an ongoing special study would be even more burdensome and less efficient than the current accounts.

IV. THE COMMISSION SHOULD ADOPT USTA'S STREAMLINING PROPOSALS

The majority of commenting parties supported USTA's streamlining proposals and the Commission should adopt these proposals in Phase 2:

-Eliminate the subaccounts and jurisdictional difference main accounts. The subaccounts serve no business purpose and the information in the jurisdictional difference main accounts are already provided to state regulators. The Oregon PUC expressed concern that elimination of the jurisdictional difference accounts would mean that certain data would not be available to state regulators.[8] That is not the case. Details will continue to be maintained for state regulators. In fact, the information that states currently receive is much more detailed than the current jurisdictional difference accounts. There are three jurisdictional difference accounts in Part 32: Total Assets, Total Liabilities and Net Income. In order to arrive at the account balances for Part 32, incumbent LECs aggregate the more detailed state data and then make journal entries to the three accounts. The Commission does not use this data. Eliminating these accounts in Part 32 would eliminate the monthly journal entry process required to enter the data into the Part 32 accounts. The underlying state data would not be affected, as the detail would continue to be maintained in the state books.

-Use GAAP to perform inventories required under Sections 32.1220(h) and 32.2311(f). The level of risk is minimal and GAAP provides sufficient guidance. Most commenters supported this proposal.

-Eliminate the thresholds that determine whether LECs can record short-term and small cost construction projects directly to plant accounts. Only one party expressed concern regarding this proposal for rate of return companies.[9] To avoid overstatement of plant in the test year, a rate of return carrier could demonstrate consistency with treatment provided on a financial GAAP basis for that year. This would ensure that different methods were not used for regulatory and GAAP purposes.

[8] Oregon PUC at 4.
[9] Utah PSC at 2.

-Adopt SFAS 116 regarding recognition of contribution costs. Contrary to the comments of several parties, adoption of SFAS 116 would not result in an increase in access charges. Price cap LECs have committed to a reduction in access charges under the CALLs agreement and rate of return LECs have proposed similar reductions under the MAG proposal. Many price cap LECs have applied for or will apply for pricing flexibility which requires the elimination of the lower formula adjustment.

-Eliminate the requirement to maintain separate subsidiary records for nonregulated revenues. While not all states would be impacted since some do not require incumbent LECs to separately report Account 5280 activities, states that regulate services that are nonregulataed at the Federal level would continue to receive information through state requirements as is the current practice. For example, the District of Columbia and Wisconsin add Directory back into state reporting. California adds simple inside wire maintenance and installation revenues and expense back into state reporting. Georgia and South Carolina add Memory Call services back into state reporting. Virginia adds services that are not preemptively deregulated back into state reporting. It makes no sense for the Commission to require accounting for services that are not regulated at the Federal level.

-Simplify the deferred tax accounting entries. No commenting parties opposed this proposal.

-Modify the detailed instructions for Telecommunications Plant accounts in Section 32.2000 by replacing them with GAAP. The internal controls associated with the SEC-required annual financial audit, GAAP and the Foreign Corrupt Practices Act provide sufficient safeguards to ensure that plant accounts reflect assets in service. This change alone could save incumbent LECs millions of dollars.

-Eliminate the requirement for notification and prior approval to adopt FASB standards. There is no need for the Commission to require incumbent LECs to conduct a costly revenue requirement study prior to the adoption of FASB standards. The FASB traditionally takes three to four years to adopt new standards and its process is open to the public. Carriers must indicate on their external financial reports when changes to FASB standards are adopted.

-Eliminate the product/service matrix in Section II of the CAM. USTA has proposed this change in its 1998 and 2000 biennial review petitions.

-Clarify that agreements under Section 252(e) are treated the same as tariffed services in Part 64. All of the parties that addressed this proposal supported treating § 252(e) publicly-filed agreements and § 252(f) statements of generally available terms as tariffed services in the Part 64 allocation process.

-Eliminate the requirement to forecast shared network investment in central office and outside plant accounts. Those parties that oppose this proposal appear to misunderstand the Part 64 allocation process. Section 64.901 of the Commission's rules provides a hierarchy by which costs should be allocated among regulated and nonregulated activities. According to the rules, first, tariffed rates should be used. As noted above, commenting states support the use of § 252(e) and (f) rates as tariffed rates in Part 64 cost allocation. Second, absent rates in step one, costs should be directly assigned to nonregulated. Third, absent either rates in step one or direct assignment, costs are to be defined as common costs. The shared network investment rules requiring forecasting only apply to common costs. Forecasting does not apply to the first two steps. As USTA and other parties explained, the nonregulated portion of shared network investment is a very small portion of the total nonregulated investment. Most new products and services have tariffed or §252(e) or (f) rates. For the small portion of shared network investment that remains after the first two steps, forecasting is unnecessary and overly burdensome. Eliminating this requirement in this limited circumstance will not impact the primary allocation steps. The Commission should allow common costs in step three, as described above, to be allocated using normal apportionment methods.

-<u>Permit incumbent LECs to expense up to $2,000 for all investment</u>. Many commenters supported this proposal. However, several states expressed concern that with a $2,000 threshold for computers, most computers would be expensed. USTA's proposal calls for flexibility to allow incumbent LECs to expense up to $2,000. It does not require incumbent LECs to do so. The intent is to raise the ceiling to allow incumbent LECs greater flexibility to align their financial and regulatory books. Therefore, not all carriers can be expected to expense items under $2,000 in all accounts since not all carriers expense all items under $2,000 in all accounts on their financial books. USTA also proposed that this change be implemented on a prospective basis. Embedded investment would continue to be subject to the current rules.

-<u>Decrease the threshold to use prevailing price in valuing affiliate transactions from fifty percent to twenty-five percent</u>. Many state regulators commented that if over 50 percent of the affiliate's sales are to an incumbent, the affiliate exists primarily to serve the incumbent. The current rules require that sales to unaffiliated third parties represent over 50 percent of all of the sales in order to qualify for prevailing price. However, it appears that the state commissions have concentrated on an affiliate's sale to an incumbent as a determining factor as to when prevailing price can be used. Only sales between an incumbent and a nonregulated affiliate should be used in calculating a percentage for prevailing price. In order to accommodate the state regulators' focus on rules related to the regulated carrier, the current rule should be changed as follows: (d) In order to qualify for prevailing price valuation in paragraphs (b) and (c) of this section, sales of a particular asset or service to third parties must encompass greater than 50 percent of the total quantity of such product or service sold ~~by an entity~~ <u>by a nonregulated affiliate to an incumbent LEC or by an incumbent LEC to a nonregulated affiliate as compared to sales to unaffiliated entities.</u> An example of how this would be implemented follows: for a nonregulated affiliate sale (where X equals total sales to the incumbent LEC and Y equals total sales to unaffiliated third parties) if Y>50%(X+Y) the affiliate can sell to the incumbent LEC at prevailing price; for an incumbent LEC sale (where X equals total sales to any nonregulated affiliate and Y equals total sales to unaffiliated third parties) if Y>50%(X+Y) the incumbent LEC can sell to a nonregulated affiliate at prevailing price.[10]

[10] As USTA explained in its comments, the threshold should be lowered to 25 percent. This threshold is sufficient to warrant use of a prevailing price. However, in the alternative, the state recommendation as explained here could be implemented in its entirety, including the proposed

-Eliminate the requirement for fair market value comparisons for asset transfers under $500,000 and set the threshold at $1 million per year between the LEC and each individual affiliate to be applied separately for sales, separately for purchases and separately by each affiliate. No commenting party opposed the establishment of a threshold. USTA urges the Commission to consider raising the proposed threshold from $500,000 to $1 million for assets. In order to implement this change, the current rule regarding asset transfers should be modified as follows: §32.27(b). Assets sold or transferred between a carrier and its affiliate pursuant to a tariff, including a tariff filed with a state commission, shall be recorded in the appropriate revenue accounts at the tariffed rate. Non-tariffed assets sold or transferred between a carrier and its affiliate that qualify for prevailing price valuation, as defined in paragraph (d) of this section, shall be recorded at the prevailing price. For all other assets sold by or transferred from a carrier to its affiliate, the assets shall be recorded at the higher of fair market value and net book cost. For all other assets purchased by or transferred to a carrier from its affiliate, the assets shall be recorded at the lower of fair market value and net book cost. For purposes of this section carriers are required to make a good faith determination of fair market value when the total annual aggregate value of the asset category (furniture, PCs, artwork, etc.) transferred between an ILEC and an individual affiliate reaches or exceeds $1,000,000. When an asset transfer between an ILEC and an individual affiliate reaches or exceeds $1,000,000 for a particular asset category for the first time, the carrier must perform the market valuation and value the transaction in accordance with the affiliate transaction rules on a going forward basis. The rules for service transfers should also be modified as stated above except that the amounts would remain at $500,000.

-Establish a floor and a ceiling for recording transactions between affiliates. Concerns raised by several state commissions that a floor and a ceiling would benefit the regulated operations to the detriment of competition opens all of the affiliate transactions rules to criticism since these rules are asymmetrical in that they are intended to benefit the regulated incumbent LEC operations. If the Commission agrees that the affiliate transactions rules are unfair to competitors and should be changed to eliminate the asymmetrical impact complained of by the state regulators, USTA proposes that the following hierarchy be used to reflect affiliate transactions in the incumbent LEC books of account: 1). The tariff (including §252 (e) or (f)) rate will be used. 2). Centralized services will be booked in the incumbent LEC books of account at fully distributed costs. Centralized services are defined as when a nonregulated affiliate provides more than 50 percent of the services to the incumbent LEC when compared to unaffiliated sales or services or when an incumbent LEC provides over 50 percent services to nonregulated affiliates when compared to unaffiliated sales. 3). Services that are not centralized services as defined in 2) will be booked in the incumbent LEC books of account at the prevailing price. 4). All asset transfers would be booked in the incumbent LEC books of account at net book. This hierarchy would eliminate the asymmetrical impacts of the current rules.

-Exempt nonregulated to nonregulated transactions from the affiliate transaction rules. None of the commenting parties opposed this proposal. Several state commissions noted that

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changes to centralized services as noted below. This alternative would provide some relief to the burdens imposed by the current rules.

they had no jurisdiction over such transactions or that they did not rely on this section of the Commission's rules.

-Expand the exception to the estimated fair market value rule to include all centralized services. While the Wisconsin PSC supported this proposal to allow centralized services provided by an incumbent LEC to be treated as a centralized service so long as the incumbent LEC provided these services solely to members of the LEC's corporate family, several states, in commenting on the application of prevailing price, observed that if over fifty percent of the affiliate's sales are to the incumbent LEC, the affiliate exists primarily to serve the incumbent LEC. These state regulators also noted that if the affiliate exists primarily to serve the incumbent, then any volume discounts the affiliate receives through its association with the incumbent should be passed on to the incumbent. That would not occur if prevailing price was used. For affiliates that exist primarily to serve the incumbent, fully distributed cost should be used to ensure that volume discounts are passed through to the incumbent. If fully distributed costs are used, the requirement regarding "solely to provide services to members of the carrier's corporate family" would no longer be necessary. USTA proposes the following alternative: All services provided by an affiliate that exists primarily to serve members of the carriers' corporate family (provides over 50 percent) and individual services provided by an ILEC primarily to members of the carriers' corporate family (provides over 50 percent) shall be recorded at fully distributed cost.

-Allow updates under Section 32.4999(l) for minor nontariffed activities treated as regulated incidental activities by eliminating the criteria that activities have been treated traditionally as regulated. Only the Utah PSC objected to this proposal. The Utah PSC was concerned that eliminating the "treated traditionally as regulated" requirement for recording minor nontariffed activities would allow carriers to subsidize nonregulated activities. The regulated pools that Utah seeks to preserve are no longer necessary, particularly under incentive regulation where prices are not based on costs. However, the three remaining tests: outgrowth of regulated operations, not a line of business and the revenue cap will ensure that carriers will not impermissibly subsidize nonregulated activities.

V. THE ARMIS REPORTS SHOULD BE SIGNIFICANTLY STREAMLINED

It is surprising that some of the state commissions want to retain the ARMIS report when practically every state has its own requirements for financial reporting from incumbent LECs.[11] Several state regulators revealed that they do not even utilize some of the ARMIS reports. For example, the Oregon PSC does not use ARMIS 43-01, 43-07, Tables B-4 and I-2 of ARMIS 43-02, and the 495A and 495B reports. The Florida PSC does not require financial reports for carriers that have opted for price regulation. Those state commissions that have legitimate needs

[11] All states except Florida require some form of financial reporting in addition to ARMIS.

for data should work with the carriers under their jurisdiction to obtain data as needed. The costs of the current ARMIS reports cannot be justified.

The ARMIS data is not complete and does not provide a complete picture of the current competitive marketplace. Thus, it is inappropriate for benchmarking purposes and cannot be used to measure competition as suggested by a few state commissions. Further, as noted previously, there are so many differences among the states in today's competitive marketplace that benchmarking at the level of detail required in the current ARMIS reports would not provide meaningful information. Adding to these reports as suggested by some commenters could place incumbent LECs at a competitive disadvantage if they are the only reporting carriers and are forced to provide information that their competitors are not required to provide regarding the deployment of new, competitive services. At the other extreme, incumbent LECs should not be forced to continue to report on outdated technology, such as the rare electromechanical switch that may still be in operation. Comments of NASUCA at p. 8.

The current ARMIS reports exceed 270 pages, not counting almost 900 pages of instructions. The Office of Management and Budget estimates that each operating company must spend a total of 4,900 hours to complete each report. Incumbent LECs cannot be expected to spend so much time filling out reports that are outdated, duplicative and under-utilized in a competitive environment. This is an outrageous example of the type of unnecessary government regulation that must be significantly streamlined and eventually eliminated. In Phase 2, USTA urges the Commission to adopt USTA's proposals to consolidate ARMIS reports 43-01, 43-02, 43-03 and 43-04 into one report and to eliminate ARMIS reports 43-07 and 43-08.

VI. ALL MIDSIZE CARRIERS SHOULD UTILIZE CLASS B ACCOUNTS AND SHOULD BE RELIEVED OF ALL REQUIREMENTS TO FILE A CAM, CONDUCT CAM AUDITS AND FILE ARMIS REPORTS

As explained above and in USTA's comments, all incumbent LECs should be permitted to utilize Class B accounts. If the Commission eliminates the Class A accounts, there is no need to establish a threshold for using Class B. However, if the Commission does not eliminate the Class A accounts, any threshold established should ensure that all mid-sized LECs are permitted to use Class B accounts and should be indexed to allow companies to grow without becoming subjected to unnecessary regulation. In addition, all mid-size carriers should be relieved from all requirements to file the CAM, conduct CAM audits and file ARMIS reports. In the staff Phase 1 workshops, the mid-sized carriers estimated that it costs $200, 000 to $300,000 per company to comply with the Commission reporting requirements. This is in addition to any state reporting that incumbent LECs may be required to perform. As the Commission has stated, this administrative burden is particularly onerous for mid-sized carriers. The Commission should continue its efforts to provide further relief for these carriers.

VII. CONCLUSION

As explained above, state regulators' concerns that data will not be available to them if USTA's streamlining proposals are adopted are unfounded. Incumbent LECs will maintain data necessary for business purposes that can be provided to the state regulators. Class A accounts are not required for universal service, UNE pricing or the allocation of costs in Part 64. The

Commission should adopt USTA's proposals and reject any suggestion to increase the current Federal accounting and reporting requirements.

Respectfully submitted

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January 30, 2001

USTA Attachment

EXPENSE OVER INVESTMENT RATIO DIFFERENCES

SOURCE ARMIS 43-03
1999 - Aggregate of All Carriers Filing ARMIS 43-03

Expense Over Investment Ratio Category	Difference Total Less Regulated	Difference Total Less Subject to Separations
General Support	**0.002349**	**0.001080**
Motor Vehicles	-0.000098	Not Available from ARMIS
Aircraft	-0.043517	Not Available from ARMIS
Tools And Other Work Equipment	-0.000417	Not Available from ARMIS
Buildings	0.001852	Not Available from ARMIS
Furniture And Artwork	-0.005045	Not Available from ARMIS
Office Equipment	-0.001668	Not Available from ARMIS
General Purpose Computers	-0.000683	Not Available from ARMIS
Central Office Switching	**0.000523**	**-0.000454**
Analog Electronic Switching	0.000009	Not Available from ARMIS
Digital Electronic Switching	0.000627	Not Available from ARMIS
Electro-mechanical Switching	0.000000	Not Available from ARMIS
Central Office Transmission	**-0.000033**	**-0.000212**
Radio Systems	0.000000	Not Available from ARMIS
Circuit Equipment	-0.000037	Not Available from ARMIS
Cable and Wire	**0.000192**	**-0.000766**
Poles	0.004325	Not Available from ARMIS
Aerial Cable	0.000030	Not Available from ARMIS
Underground Cable	-0.000010	Not Available from ARMIS
Buried Cable	0.000031	Not Available from ARMIS
Submarine Cable	-0.000004	Not Available from ARMIS
Deep Sea Cable	0.000000	Not Available from ARMIS
Intrabuilding Network Cable	0.000003	Not Available from ARMIS
Aerial Wire	0.000000	Not Available from ARMIS
Conduit Systems	-0.000007	Not Available from ARMIS

CERTIFICATE OF SERVICE

I, Meena Joshi, do certify that on January 30, 2001, Reply Comments Of The United States Telecom Association was either hand-delivered, or deposited in the U.S. Mail, first-class, postage prepaid to the attached service list.

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